

REPORT OF EXAMINATION
OF THE
EXPLORER INSURANCE COMPANY
AS OF
DECEMBER 31, 2009

Participating State
and Zone:

California

Filed January 21, 2011

TABLE OF CONTENTS

| | <u>PAGE</u> |
|--|-------------|
| SCOPE OF EXAMINATION..... | 1 |
| MANAGEMENT AND CONTROL: | 2 |
| Management Agreements | 4 |
| TERRITORY AND PLAN OF OPERATION..... | 4 |
| REINSURANCE: | 5 |
| Intercompany Pooling Agreement | 5 |
| Assumed..... | 5 |
| Ceded | 5 |
| ACCOUNTS AND RECORDS:..... | 5 |
| Information Systems Controls | 5 |
| FINANCIAL STATEMENTS: | 6 |
| Statement of Financial Condition as of December 31, 2009 | 7 |
| Underwriting and Investment Exhibit for the Year Ended December 31, 2009 | 8 |
| Reconciliation of Surplus as Regards Policyholders from December 31, 2005 through December 31, 2009 | 9 |
| COMMENTS ON FINANCIAL STATEMENT ITEMS: | 10 |
| Losses and Loss Adjustment Expenses..... | 10 |
| SUMMARY OF COMMENTS AND RECOMMENDATIONS:..... | 10 |
| Current Report of Examination..... | 10 |
| Previous Report of Examination..... | 10 |
| ACKNOWLEDGEMENT | 11 |

Los Angeles, California
November 17, 2010

Honorable Alfred W. Gross
Chairman of the NAIC Financial
Condition Subcommittee
Commissioner of Insurance
Virginia Bureau of Insurance
Richmond, Virginia

Honorable Christina Urias
Secretary, Zone IV-Western
Director of Insurance
Arizona Department of Insurance
Phoenix, Arizona

Honorable Steve Poizner
Insurance Commissioner
California Department of Insurance
Sacramento, California

Dear Chairman, Secretary, and Commissioner:

Pursuant to your instructions, an examination was made of the

EXPLORER INSURANCE COMPANY

(hereinafter also referred to as the Company) at its home office located at 11455 El Camino Real, San Diego, California 92130.

SCOPE OF EXAMINATION

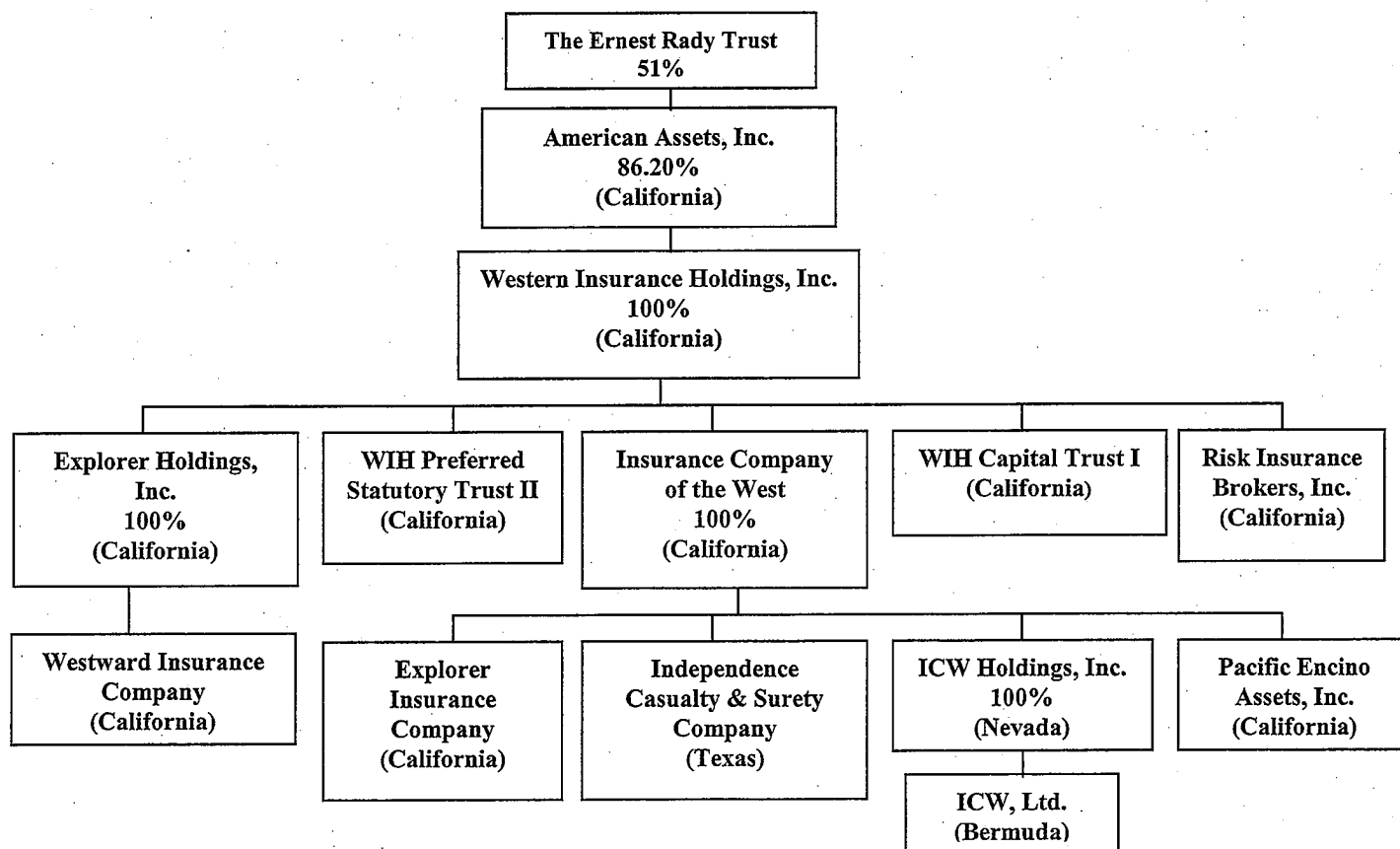
The previous examination of the Company was made as of December 31, 2005. This examination covers the period from January 1, 2006 through December 31, 2009. The examination was conducted pursuant to the National Association of Insurance Commissioners' plan of examination. The examination included a review of the Company's practices and procedures, an examination of management records, tests and analyses of detailed transactions within the examination period, and an evaluation of the assets and a determination of liabilities as of December 31, 2009 as deemed necessary under the circumstances.

The examination was conducted concurrently with the examination of the Company's parent, Insurance Company of the West.

In addition to those items specifically commented upon in this report, other phases of the Company's operations were reviewed including the following areas that require no further comment: company history; corporate records; fidelity bonds and other insurance; officers', employees' and agents' welfare and pension plans; growth of company; business in force by states; loss experience; and sales and advertising.

MANAGEMENT AND CONTROL

Ultimate control of the Company is maintained by Ernest S. Rady and family members. The following organizational chart depicts the Company's relationship within the holding company system:



Management of the Company is vested in a five-member board of directors elected annually. A listing of the members of the board and principal officers serving on December 31, 2009 follows:

Directors

| <u>Name and Residence</u> | <u>Principal Business Affiliation</u> |
|---|--|
| Mary J. Boyd* Valencia, California | Senior Vice President Insurance Company of the West |
| Bernard M. Feldman Del Mar, California | Former President Insurance Company of the West |
| Neal A. Fuller Del Mar, California | Senior Vice President and Treasurer Insurance Company of the West |
| Kevin M. Prior San Diego, California | President and Chief Executive Officer Insurance Company of the West |
| Ernest S. Rady San Diego, California | Chairman of the Board Insurance Company of the West |

Principal Officers

| <u>Name</u> | <u>Title</u> |
|--------------------|---------------------------------------|
| Kevin M. Prior | President and Chief Executive Officer |
| Neal A. Fuller | Senior Vice President and Treasurer |
| Mary J. Boyd* | Senior Vice President |
| James D. Browne | Senior Vice President |
| Fariborz Rostamian | Vice President and Controller |
| Mary E. Cannon | Vice President and Secretary |

*Resigned March 1, 2010 and replaced by Stephen Marshall, Senior Vice President

Management Agreements

Tax Allocation Agreement: Since January 1, 1996 the Company and its affiliates have been parties to a consolidated federal income tax agreement with the ultimate parent, American Assets, Inc. (AA). Allocation of taxes is based upon separate return calculations with current credit for net losses. Upon review, intercompany tax balances were found to be settled in accordance with the terms of the agreement. The tax allocation agreement did not require prior approval by the California Department of Insurance.

TERRITORY AND PLAN OF OPERATION

As of December 31, 2009, the Company was licensed to write various property and casualty coverages in the following 17 states:

| | | | |
|------------|----------|--------------|------------|
| Arizona | Idaho | Nevada | Utah |
| California | Illinois | New Mexico | Washington |
| Colorado | Indiana | Oregon | |
| Florida | Iowa | Pennsylvania | |
| Hawaii | Montana | Texas | |

The Company specializes in nonstandard private passenger automobile liability and physical damage coverages. During 2009, the Company wrote \$174.9 million of direct premiums. Of the total direct premiums written, \$155.3 million (89.0%) was written in California. Business is produced through approximately 700 independent agents.

Branch offices are maintained in Concord, Fresno, Pleasanton, Sacramento, Santa Clarita, Tustin and Ventura, California; Chicago, Illinois; Dallas and Houston, Texas; Denver, Colorado; Las Vegas, Nevada; Portland, Oregon; Jackson, Mississippi; Memphis, Tennessee; Orlando, Florida; and Seattle, Washington.

REINSURANCE

Intercompany Pooling Agreement

Under the terms of an Intercompany Pooling Agreement, the Company and its affiliate, Independence Casualty and Surety Company (Independence), cede 100% of their written premiums to their parent, Insurance Company of the West (ICW). ICW, in turn, retrocedes a 15% and 1.5% pro rata portion of premiums, losses and expenses to the Company and Independence, respectively.

Assumed

Assumed business is limited to the Company's participation in the above referenced intercompany pooling agreement.

Ceded

Ceded business is limited to the Company's participation in the above referenced intercompany pooling agreement.

ACCOUNTS AND RECORDS

Information Systems Controls

A consulting firm contracted by the California Department of Insurance conducted a review of the Company's information system general controls. As referenced in the consultant's report, it is recommended that management review the policies and practices related to business continuity planning, physical security, security and access controls, and program change controls.

FINANCIAL STATEMENTS

The financial statements prepared for this examination report include:

Statement of Financial Condition as of December 31, 2009

Underwriting and Investment Exhibit for the Year Ended December 31, 2009

Reconciliation of Surplus as Regards Policyholders
from December 31, 2005 through December 31, 2009

Statement of Financial Condition
as of December 31, 2009

| <u>Assets</u> | <u>Ledger and Nonledger Assets</u> | <u>Assets Not Admitted</u> | <u>Net Admitted Assets</u> | <u>Notes</u> |
|---|--|--------------------------------|--------------------------------|--------------|
| Bonds | \$ 69,250,126 | \$ | \$ 69,250,126 | |
| Preferred stocks | 253,130 | | 253,130 | |
| Common stocks | 4,244,149 | | 4,244,149 | |
| Cash and short-term investments | 13,107,800 | | 13,107,800 | |
| Receivable for securities | 16,648,866 | | 16,648,866 | |
| Investment income due or accrued | 549,038 | | 549,038 | |
| Uncollected premiums and agents' balances in course of collection | 4,712,870 | 1,605,158 | 3,107,712 | |
| Deferred premiums, agents' balances and installments booked but deferred and not yet due | 83,479,813 | | 83,479,813 | |
| Current federal and foreign income tax recoverable | 1,462,830 | | 1,462,830 | |
| Net deferred tax asset | 4,552,211 | 765,890 | 3,786,321 | |
| Guaranty funds receivable or on deposit | 289,998 | | 289,998 | |
| Aggregate write-ins for other than invested assets | <u>216,852</u> | | <u>216,852</u> | |
| Total assets | <u>\$ 198,767,683</u> | <u>\$ 2,371,048</u> | <u>\$ 196,396,635</u> | |

Liabilities, Surplus and Other Funds

| | | | |
|--|-------------------|-----------------------|-----|
| Losses | | \$ 45,448,918 | (1) |
| Loss adjustment expenses | | 13,515,175 | (1) |
| Commissions payable, contingent commissions and other similar charges | | 546,957 | |
| Other expenses | | (251,442) | |
| Taxes, licenses and fees | | 1,631,233 | |
| Unearned premiums | | 19,234,464 | |
| Ceded reinsurance premiums payable | | 72,565,000 | |
| Amounts withheld or retained by company for account of others | | (21,882) | |
| Payable to parent, subsidiaries and affiliates | | 2,477,765 | |
| Payable for securities | | 6,648 | |
| Aggregate write-ins for liabilities | | <u>140,010</u> | |
| Total liabilities | | 155,292,846 | |
| Common capital stock | \$ 2,600,000 | | |
| Gross paid-in and contributed surplus | 8,070,835 | | |
| Unassigned funds (surplus) | <u>30,432,954</u> | | |
| Surplus as regards policyholders | | <u>41,103,789</u> | |
| Total liabilities, surplus and other funds | | <u>\$ 196,396,635</u> | |

Underwriting and Investment Exhibit
for the Year Ended December 31, 2009

Statement of Income

Underwriting Income

| | | |
|--------------------------------------|-------------------|-------------------|
| Premiums earned | | \$ 56,377,572 |
| Deductions: | | |
| Losses incurred | \$ 31,326,592 | |
| Loss expenses incurred | 7,795,307 | |
| Other underwriting expenses incurred | <u>23,691,193</u> | |
| Total underwriting deductions | | <u>62,813,092</u> |
| Net underwriting loss | | (6,435,520) |

Investment Income

| | | |
|------------------------------|------------------|-----------|
| Net investment income earned | \$ 4,205,610 | |
| Net realized capital gains | <u>3,155,979</u> | |
| Net investment gain | | 7,361,589 |

Other Income

| | | |
|---|------------------|---------------------|
| Net loss from agents' or premium balances charged off | \$ (3,386,830) | |
| Finance and service charges not included in premiums | 750,688 | |
| Aggregate write-ins for miscellaneous income | <u>2,382,538</u> | |
| Total other income | | <u>(253,604)</u> |
| Net income before dividends to policyholders and before federal income taxes | | 672,465 |
| Dividends to policyholders | | 352,344 |
| Federal and income taxes incurred | | <u>(905,271)</u> |
| Net income | | <u>\$ 1,225,392</u> |

Capital and Surplus Account

| | | |
|---|-----------------|----------------------|
| Surplus as regards policyholders, December 31, 2008 | | \$ 41,744,350 |
| Net income | \$ 1,225,392 | |
| Change in net unrealized capital gains | 197,150 | |
| Change in net deferred income tax | (209,692) | |
| Change in nonadmitted assets | (1,784,409) | |
| Aggregate write-ins for losses in surplus | <u>(69,002)</u> | |
| Change in surplus as regards policyholders | | <u>(640,561)</u> |
| Surplus as regards policyholders, December 31, 2009 | | <u>\$ 41,103,789</u> |

Reconciliation of Surplus as Regards Policyholders
from December 31, 2005 through December 31, 2009

Surplus as regards policyholders, December 31, 2005
per Examination

\$ 28,448,268

| | <u>Gain in Surplus</u> | <u>Loss in Surplus</u> |
|--|----------------------------|----------------------------|
| Net income | \$ 15,915,841 | \$ |
| Change in net unrealized capital losses | | 8,534,481 |
| Change in net deferred income tax | 1,801,012 | |
| Change in nonadmitted assets and related items | | 1,906,048 |
| Aggregate write-ins for gains in surplus | <u>5,379,197</u> | |
| Totals | <u>\$ 23,096,050</u> | <u>\$ 10,440,529</u> |

Net increase in surplus as regards policyholders

12,655,521

Surplus as regards policyholders, December 31, 2009
per Examination

\$ 41,103,789

COMMENTS ON FINANCIAL STATEMENT ITEMS

(1) Losses and Loss Adjustment Expenses

Based on the analysis by a Casualty Actuary from the California Department of Insurance, the Company's December 31, 2009 reserves for losses and loss adjustment expenses were determined to be reasonably stated.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

Accounts and Records – Information System Controls (Page 5): It is recommended that management review the policies and practices related to business continuity planning, physical security, security and access controls, and program change controls.

Previous Report of Examination

Accounts and Records (Page 6): It was recommended that the disaster recovery plan be tested at the earliest possible time. The Company is in compliance with the recommendation.

ACKNOWLEDGEMENT

The courtesy and cooperation extended by the Company's officers and employees during the course of this examination are hereby acknowledged.

Respectfully submitted,

/S/

David A. Fischman, CFE
Examiner-In-Charge
Senior Insurance Examiner
Department of Insurance
State of California